FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

FIRST PACIFIC BANK; FIRST PACIFIC BANCORP, INC., *Plaintiffs-Appellants,* v. JAMES E. GILLERAN; CALIFORNIA STATE BANKING DEPARTMENT; FEDERAL DEPOSIT INSURANCE CORPORATION, as Receiver for First Pacific Bank, *Defendants-Appellees.*	No. 91-55890 D.C. No. CV-90-6563-JGD
FIRST PACIFIC BANK; FIRST PACIFIC BANCORP, INC., *Plaintiffs-Appellees,* v. JAMES E. GILLERAN; CALIFORNIA STATE BANKING DEPARTMENT, *Defendants-Appellants.*	No. 91-56081 **OPINION**

Appeals from the United States District Court
for the Central District of California
John G. Davies, District Judge, Presiding

Argued and Submitted
July 15, 1994 – Pasadena, California

Filed November 21, 1994

Before: J. Clifford Wallace, Chief Judge, Stephen Reinhardt, Circuit Judge, and Jack E. Tanner,* District Judge.

Opinion by Chief Judge Wallace

SUMMARY

Banking/FDIC and FSLIC/Government Regulation

The court of appeals affirmed a district court judgment. The court held that for purposes of analyzing whether a bank's contributed capital was impaired, a bank's deficit retained earnings could not be reduced by an amount of loan loss reserves.

The State of California seized control of appellant First Pacific Bank pursuant to California Financial Code § 3100 because, among other things, it concluded that the Bank's contributed capital was impaired. The State appointed appellee the Federal Deposit Insurance Corp. (FDIC) as receiver for the Bank.

The Bank and its owners brought suit to reverse the seizure. The district court entered summary judgment confirming the seizure. The court concluded that the Bank's contributed capital was impaired. The Bank appealed. The State cross-appealed from an earlier ruling that a capital note should be included in the Bank's contributed capital.

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* Honorable Jack E. Tanner, United States District Judge, Western District of Washington, sitting by designation.

[1] Under California Financial Code § 134, contributed capital consists of the bank's shareholders' equity, other than retained earnings. Section 134(b) provides that a bank's contributed capital is impaired when the bank has deficit retained earnings in an amount exceeding 40 percent of its contributed capital. [2] The Code requires that the impairment analysis be performed using figures for contributed capital and retained earnings that would be presented on a balance sheet prepared in accordance with generally accepted accounting principles (GAAP).

[3] In this case, the Bank's figures showed deficit retained earnings which exceeded 40 percent of contributed capital. Thus, according to these figures, the Bank's contributed capital was impaired.

[4] The Bank argued that for purposes of the impairment analysis, its deficit retained earnings should be reduced by an amount of loan loss reserves and an amount in deferred loan fees. However, because the impairment calculation must be performed using contributed capital and deficit retained earnings figures as they would be presented on a balance sheet prepared in accordance with GAAP, these adjustments could not be made. [5] Deficit retained earnings may not be reduced by loan loss reserves.

[6] The language and structure of the California Financial Code indicated that the district court reached an incorrect result when it considered the Bank's capital note as contributed capital. Under the Code, a capital note is considered to be a liability. [7] The capital note

was not a part of shareholders' equity or GAAP contributed capital. A capital note clearly provides a less desirable financial cushion than equity.

[8] Because the Bank failed to seek discovery from the FDIC, the entity that it knew had its records, the district court did not err by entering summary judgment without first ruling on the Bank's motion for discovery.

COUNSEL

Brant M. Laue, Rouse, Hendricks, German, May & Shank, Kansas City, Missouri, for the plaintiffs-appellants-cross-appellees.

Joseph M. O'Heron, Deputy Attorney General, Los Angeles, California, for the defendants-appellees-cross-appellants.

OPINION

WALLACE, Chief Judge:

On August 10, 1990, the State of California (State) seized control of First Pacific Bank (Bank) pursuant to California Financial Code (Financial Code) § 3100 because, among other things, it concluded that the Bank's contributed capital was impaired. The State appointed the Federal Deposit Insurance Corporation (FDIC) as receiver for the Bank. In accordance with Financial Code § 3101, the Bank and its owners brought suit in state court to reverse the seizure. The FDIC removed the case to federal district court pursuant to 12 U.S.C.

§ 1819(b)(2)(B). The district court entered summary judgment confirming the seizure.

The Bank now appeals from the district court's summary judgment, and its conclusion that its contributed capital was impaired. The State cross-appeals from an earlier ruling that a capital note should be included in the Bank's contributed capital. We have jurisdiction over these timely appeals pursuant to 28 U.S.C. § 1291. We affirm, but for reasons different than those stated by the district court.

I

The Bank argues that summary judgment was improper because there was a genuine issue of material fact as to whether its contributed capital was impaired. We review a summary judgment de novo. *Jones v. Union Pac. R.R.*, 968 F.2d 937, 940 (9th Cir. 1992). Our tasks on appeal are to determine (1) whether there is a genuine issue of material fact when the evidence is viewed in the light most favorable to the nonmoving party, and (2) whether the district court correctly applied the law. *Tzung v. State Farm Fire & Cas. Co.*, 873 F.2d 1338, 1339-40 (9th Cir. 1989). On appeal, we may affirm on any ground supported by the record. *United States v. Washington*, 969 F.2d 752, 755 (9th Cir. 1992), *cert. denied*, 113 S. Ct. 1945 (1993).

[1] The starting place for our analysis is Financial Code § 134, which provides the statutory definition of contributed capital and the formula for determining whether a bank's contributed capital is impaired. According to section 134(a), contributed capital consists of "all of

[the Bank's] shareholders' equity other than retained earnings." Section 134(b) provides that the Bank's contributed capital "shall be deemed to be impaired whenever such bank has deficit retained earnings in an amount exceeding 40 percent of such contributed capital."

[2] The Financial Code requires that the impairment analysis be performed using figures for contributed capital and retained earnings that would be presented on a balance sheet prepared in accordance with generally accepted accounting principles (GAAP):

> All references . . . to financial statements, balance sheets . . . and all references to assets, liabilities, earnings, retained earnings, shareholders' equity, and similar accounting items of a bank mean such financial statements or such items prepared or determined in conformity with generally accepted accounting principles then applicable, fairly presenting in conformity with generally accepted accounting principles the matters which they purport to present. . . .

Cal. Fin. Code § 118 (1978).

The State argues that the Bank's own financial statements demonstrate that its contributed capital is impaired, even before they are adjusted to compensate for the overvaluation of the Bank's assets. The record contains at least three sets of calculations that differ in minor amounts because they use figures from three different dates. Each calculation, however, shows that the Bank's contributed capital is impaired. For the sake of simplicity, we will use the figures for August 10, 1990, as found in the Bank's brief on appeal.

[3] The Bank's figures show $4,945,880 in contributed capital, consisting of $1,922,865 in common stock and $3,023,015 in additional paid in capital. Forty percent of contributed capital is $1,978,352. The Bank's figures also show $2,700,007 in deficit retained earnings, which exceeds forty percent of contributed capital by $721,655. Thus, according to these figures the Bank's contributed capital was impaired.

The Bank argues that these figures are from "interim, unadjusted" statements prepared for internal use that must be adjusted to conform with GAAP. The Bank proposes that: (A) loan loss reserves totaling $1,507,137 and deferred loan fee income totaling $481,587 should be deducted from deficit retained earnings; (B) a capital note worth $844,000 should be included in contributed capital; and (C) deficit retained earnings should be reduced by $390,553 to reflect adjustments necessary to bring the financial statements in line with GAAP.

If each of the Bank's proposed adjustments is accepted, its contributed capital of $4,945,880 would be increased by $844,000 to equal $5,789,880. Forty percent of contributed capital would be $2,315,952. Deficit retained earnings of $2,700,007 would be reduced by amounts of $1,507,137, $481,587, and $390,553 to equal $320,730. According to these adjusted figures the Bank's deficit retained earnings would be $1,995,222 below the impairment mark. We address each of the Bank's arguments in turn.

A.

Loan loss reserves are credit accounts on the asset side of the balance sheet, created by accounting entries that have the effect of increasing deficit retained earnings. They are estimates, required by GAAP, to reduce the recorded value of a loan portfolio to account for loans that will become uncollectible in the future. Deferred loan fees are also credit accounts on the asset side of the balance sheet. They represent fees which the Bank has already received, but for which the earnings process is not yet complete. Because the recognition of these fees is deferred, they have the effect of increasing deficit retained earnings.

[4] The Bank argues that for purposes of the impairment analysis, its deficit retained earnings should be reduced by $1,507,137 in loan loss reserves and $481,587 in deferred loan fees. However, because the impairment calculation must be performed using contributed capital and deficit retained earnings figures as they would be presented on a balance sheet prepared in accordance with GAAP, these adjustments cannot be made. Cal. Fin. Code § 118 (1978).

The Bank contends that the declarations of three certified public accountants, demonstrate that the adjustments can be made consistent with GAAP. Nowhere in these declarations, however, is there a statement that including loan loss reserves and deferred fees in deficit retained earnings is consistent with GAAP.

The Bank also argues that the administrative record shows that a state bank examiner had previously included loan loss reserves in deficit retained earnings

when calculating the impairment of the Bank's contributed capital. But the Bank has taken this calculation out of context. The bank examiner's calculation was based on adjusted financial statements. Because the adjustments increased deficit retained earnings by over $6 million after writing off uncollectible loans, it was also necessary to reverse the $1.5 million estimated allowance for those same losses. But these adjusted calculations are irrelevant because the State chose to proceed on summary judgment using unadjusted figures.

The Bank also argues that loan loss reserves are part of the Bank's capital. This may be true, but it is also irrelevant because capital is not the same as deficit retained earnings.

[5] Our conclusion that deficit retained earnings may not be reduced by loan loss reserves is also supported by an understanding of the function of such reserves. Loan loss reserves are established in order to reflect the reality that a loan portfolio is not worth the total outstanding balance of such loans. By establishing a loan loss reserve, a bank effectively reduces the statement of loan values to an estimate of their net realizable value. If a bank's deficit retained earnings are reduced by the amount of its loan loss reserves, the actual financial condition of the bank may be overstated. Therefore, it makes sense not to allow deficit retained earnings to be reduced by the amount of a bank's loan loss reserves.

B.

A capital note is a liability that can be converted into common stock. Therefore it has characteristics of both

debt and equity. The Bank successfully argued before the district court that its $844,000 capital note should be considered contributed capital. The State cross-appeals from the district court's ruling in the Bank's favor.

[6] The language and structure of the Financial Code indicate that the district court reached an incorrect result. The Financial Code defines contributed capital as "all of shareholders' equity other than retained earnings." Cal. Fin. Code § 134(a) (1978). Thus, in order for a capital note to be contributed capital it must first be an element of shareholders' equity. However, article 4 of the Financial Code, entitled "Shareholders' Equity," considers a capital note to be a liability. *Id.* § 660 (liabilities include but are not limited to "capital notes or debentures and any contingent liabilities"). The conclusion that capital notes are not part of shareholders' equity is further supported by five sections of the Financial Code that list capital notes and shareholders' equity as separate items. *See id.* §§ 670, 763, 1221, 1224, 1231.

The Bank contends that the State has recognized the capital note as part of the bank's capital for all purposes. But capital is not the same as contributed capital. *See Board of Governors v. First Lincolnwood Corp.*, 439 U.S. 234, 240 n.7 (1978) ("While the Board considers capital notes that are subordinated to depositors' demands to be part of a bank's overall capital, it regards them as a less desirable financial cushion than equity.").

The Bank also argues that because a capital note is readily convertible into common stock, GAAP would allow it to be included in contributed capital for purposes

of the impairment analysis. However, none of the declarations filed by the Bank's certified public accountants support this conclusion. The most telling declaration is that of John Bovard Miron, who states that "it is appropriate for purposes of the calculation of impaired capital under California Financial Code Section 134(b) that . . . the capital notes be added back to GAAP contributed capital." The very strong negative inference is that the capital note is not a part of GAAP contributed capital. The statutory requirement that GAAP contributed capital be used in the impairment analysis negates the suggested propriety of the adjustment. *See* Cal. Fin. Code § 118 (1978).

[7] Our conclusion that the capital note is not a part of shareholders' equity or GAAP contributed capital is confirmed by an analysis of the nature of the financial instrument. As we have already explained, a capital note is a hybrid instrument which has characteristics of both debt and equity. Indeed, that the capital note can mandatorily be converted into common stock and that the principal of the note need not be repaid suggest that the capital note would provide a financial cushion similar to that of equity. The capital note has other features, however, which make it more akin to debt. The capital note requires the Bank to make payments of interest to the holder of the note. In addition, although sections 642 through 645 of the Financial Code restrict a bank's ability to pay dividends and to make other distributions to shareholders on the basis of its earnings and shareholders' equity, the holder of the capital note has a legally enforceable right to interest payments regardless of

whether the bank would be prohibited from making distributions to its shareholders. That a bank could be forced to make interest payments on a capital note even while it is encountering financial distress strongly suggests that a capital note is not the equivalent of equity. A capital note clearly provides a less desirable financial cushion than equity, and is properly excluded from shareholders' equity and GAAP contributed capital.

C.

The Bank argues that deficit retained earnings should be reduced by $390,553 to reflect necessary adjustments to the financial statements. The State concedes that adjustments are necessary, but disputes the amount of the adjustments. This issue prompted a series of dueling affidavits in the district court. Ultimately, the district court accepted the State's affidavits, stating that it found the Bank's second declaration "somewhat suspicious."

In reviewing the district court's summary judgment, our task "is not . . . to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249 (1986). Here, however, any genuine issue created by these affidavits does not relate to a material fact. In light of our previous conclusions, the Bank's proposed adjustment would not avert the impairment of its contributed capital.

We conclude that the Bank's contributed capital was impaired. The Bank's own figures show contributed capital of $4,945,880, forty percent of which is $1,978,352. The Bank's figures also show $2,700,007 in deficit retained

earnings. Even if this figure were reduced by $390,553 to equal $2,309,454, the Bank's contributed capital would still be impaired by $331,102.

II

The Bank argues that summary judgment was improper because it was denied an opportunity to conduct discovery. The State counters that discovery was not necessary because the inquiry was limited to the administrative record. The district court entered summary judgment without ruling on the Bank's pending motion for discovery from the State. "Because the district court did not exercise its discretion, the issue of whether or not it should have presents a legal question which is subject to de novo review." *Garrett v. City & County of San Francisco*, 818 F.2d 1515, 1518 n.3 (9th Cir. 1987).

The State is justified in seizing a bank when the bank's own financial statements demonstrate that its contributed capital is impaired. *FDIC v. Bank of San Marino*, 167 Cal. App. 3d 247, 255 (1985). When, as in this case, the State has relied on the Bank's own financial statements without making any adjustments, the Bank will be hard pressed to show the relevance of any discovery beyond its own records and the State's administrative record.

[8] The Bank contends that by the lack of discovery it was denied access to its own records and, therefore, could not determine the extent to which the statements needed to be adjusted to conform with GAAP. However, these records were in the possession of the FDIC, not the State. The Bank did not seek discovery from the FDIC,

even though it knew that the FDIC was in exclusive possession of its records. Because the Bank failed to seek discovery from the entity that it knew had its records, we conclude that the district court did not err by entering summary judgment without first ruling on the Bank's motion for discovery.

III

In California, when the State takes possession of a bank, the process that is due to the bank is a "hearing and a determination of the facts upon the merits." Cal. Fin. Code § 3101 (1951). The Bank argues that the summary judgment proceeding was not a sufficient hearing, relying on *Trede v. Superior Court*, 134 P.2d 745, 747 (Cal.) (A seized institution may challenge the sate in "a judicial proceeding in which it may present evidence."), *cert. denied*, 320 U.S. 739 (1943), and *Pacific States Sav. & Loan Co. v. Hise*, 155 P.2d 809, 811 (Cal. 1945) (extensive trial held). These cases do not support the argument that summary judgment violates either section 3101 or due process. If the Bank had been able to establish the existence of a genuine issue of material fact, it would have been entitled to a trial. As it was, the Bank was given the opportunity to present evidence. The district court then properly entered summary judgment on the merits. This is all that is required by section 3101.

AFFIRMED.

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

FIRST PACIFIC BANK, and FIRST PACIFIC BANCORP, INC., Plaintiffs, v. JAMES E. GILLERAN, SUPERINTENDENT OF BANKS, et al., Defendants.	CASE NO. CV 90-6563 JGD ORDER DENYING DEFENDANTS' MOTION FOR SUMMARY JUDGMENT (Filed May 15, 1991)

On May 6, 1991, the Court heard the following motions: (1) defendants' motion for summary judgment; (2) plaintiffs' motion to stay liquidation; (3) plaintiffs' motion for an order granting discovery; and (4) defendants' motion for sanctions. After due consideration of the arguments presented at that hearing, as well as those presented in the written briefing, the Court HEREBY DENIES defendants' motion for summary judgment.[1]

Factual Background

On August 10, 1990, James E. Gilleran, Superintendent of Banks of the State of California, pursuant to power vested in him under California Financial Code §3100 et seq., took possession of the business and property of First Pacific Bank ("Bank"). On that same day, by

[1] The balance of the motions scheduled for hearing on May 6, 1991 will be rescheduled as set forth below.

previous arrangement, the Superintendent appointed the Federal Deposit Insurance Corporation ("FDIC") as receiver of the Bank and since that day, the FDIC has acted as its receiver.

On August 20, 1990, the Bank filed an action in California Superior Court pursuant to its rights under Financial Code §3101 to challenge the closing of the Bank and seek return of its assets.[2] The FDIC was not named in that action. On November 1, 1990, the Bank filed an amended complaint naming the FDIC as a party to the action. The state court allowed the amended complaint despite the fact that §3101 facially requires filing of an action within 10 days of the bank takeover. The FDIC was served with the amended complaint on either November 3, or November 7, 1990. Proof of service was filed in the superior court on November 16, 1990. On December 3, 1990, the FDIC filed a petition removing the case to this Court. On February 7, 1991, the Court denied plaintiffs' motion to remand.

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[2] Financial Code §3101 provides:
"Whenever the superintendent has taken possession of the property and business of any bank, such bank, within 10 days after such taking, if it deems itself aggrieved thereby, may apply to the superior court in the county in which the head office of such bank is located to enjoin further proceedings. The court, after citing the superintendent to show cause why further proceedings should not be enjoined and after a hearing and a determination of the facts upon the merits may dismiss such application or enjoin the superintendent from further proceedings and direct him to surrender the property and business to such bank."

Motion for Summary Judgment

In support of their motion for summary judgment, defendants argue that California Financial Code §3100 authorizes summary seizure of the property and business of a bank when that entity's contributed capital is impaired. Pursuant to Financial Code §134(b), contributed capital of a bank is impaired whenever the bank has deficit retained earnings that exceed 40% of contributed capital. Defendants contend that summary judgment is mandated here because, in their view, the financial records of the bank reflected deficit retained earnings exceeding 40% of contributed capital at the time of seizure.

In response, plaintiffs contend that the defendants erred in their calculation of both the bank's contributed capital and its deficit retained earnings. Plaintiffs argue that the balance sheet entries for convertible capital notes and loan loss allowance should be included in the calculation of contributed capital and that once these items are included, the bank's records would not reflect impairment of contributed capital. Similarly, plaintiffs contend that the deficit retained earnings figure used by the defendants in determining impairment did not reflect certain accounting adjustments which are not reflected in the internal financial statements of the bank until the end of each quarter.

The real issue raised by defendants' motion is this: does a factual dispute exist as to whether contributed capital was impaired on the date that defendant banking superintendent seized plaintiffs' business and assets? To decide this question, the Court must interpret Financial

Code §134. Specifically, the Court must determine which balance sheet items should be included in the definition of "contributed capital", as that term is used in the analysis of impairment of contributed capital.

The applicable statutory framework provides as follows. Financial Code §3100(a) states:

> "Whenever it appears to the superintendent that: (a) The contributed capital of any bank is impaired . . . the superintendent may forthwith take possession of the property and business of such bank and retain possession until such bank resumes business or its affairs be finally liquidated as herein provided."

The defendants assert that their actions of August 10, 1990 were based on this provision. Lending definition to the critical terms of §3100, §134(b) states:

> "For purposes of this division, the contributed capital of a bank shall be deemed to be impaired whenever such bank has deficit retained earnings in an amount exceeding 40 percent of such contributed capital."

In turn, §134(a) defines contributed capital as:

> " . . . all of shareholders' equity other than retained earnings. However, nothing in this subdivision shall prohibit a bank from transferring amounts from time to time from its retained earnings to its contributed capital, subject to any applicable statutes, regulations, and generally accepted accounting principles."

The issue now before the Court turns on the interpretation of §134(a) which defines contributed capital.

Simply stated, if contributed capital is calculated in accordance with the defendants' methodology, then deficit retained earnings exceeded 40 percent of contributed capital and the superintendent was correct in finding impairment and justified in taking action under §3100 to seize the business and property of the bank.[3] If so, plaintiffs' challenge suit should be allowed to go no further.

Defendants' computation includes amounts in only the accounts entitled (1) common stock, and (2) additional paid-in capital. On the other hand, plaintiffs propose a computation of contributed capital which also includes: (1) capital notes, and (2) allowance for loan losses. Were the Court to find that these additional amounts should be considered part of contributed capital, deficit retained earnings would not have exceeded 40 percent of contributed capital at the time of the superintendent's takeover.[4] In such event, defendants would not

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[3] Defendants' computation, based on the bank's internal consolidated balance sheet as of July 31, 1990, was as follows:

common stock	$1,922,865
additional paid-in capital	3,023,015
contributed capital	$4,945,880
	x 40%
40% of contributed capital	$1,978,352
deficit retained earnings	$2,531,073

Here, deficit retained earnings exceed forty percent of contributed capital. *See also* Declaration of Joseph R. Phelon, filed in support of defendants' motion.

[4] Plaintiffs' computation, based on the bank's internal consolidated balance sheet as of July 31, 1990, is as follows:

common stock	$1,922,865
additional paid-in capital	3,023,015

be entitled to summary judgment and plaintiffs would be entitled to proceed with their challenge suit in accordance with Financial Code §3101.

1. Capital Notes

Plaintiffs claim that, by its own terms, the bank's "Mandatorily Convertible Subordinated Capital Note" should be included in the computation of contributed capital. The capital note was issued by First Pacific Bank to its parent, First Pacific Bancorp. The declaration of Joseph J. Stein, filed in support of plaintiff's opposition to summary judgment, states that the $844,000 note is convertible into 281,052 shares of common stock on its fifth anniversary (May, 1993), if not retired sooner. He declares that the terms and conditions of the note indicate that there is absolutely no requirement for repayment.

Moreover, plaintiffs argue that the capital note should be included in the computation of contributed capital here because the State Banking Department, stated in an October, 1988 letter that "the amount of the capital note may now be included in capital for all purposes, including the calculation of lending limits." *See* Declaration of John Bovard Miron, Ex. E.

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subordinated capital note	844,000
reserve for loan losses	1,506,577
contributed capital	$7,296,457
	x 40%
40% of contributed capital	$2,918,583
deficit retained earnings	$2,531,073

In response, defendants argue that despite its sweeping language, the Banking Department's letter of October, 1988 does not indicate that the capital note may be included in *contributed* capital, and to interpret the phrase "may be included in capital for all purposes" literally would be inconsistent with other indications in the Financial Code that capital notes are separate and distinct from shareholders' equity. For example, Financial Code §670, which authorizes the issuance of capital notes and imposes restrictions upon their repayment, refers at one point to "the aggregate of the shareholders' equity and capital notes". Defendants contend that this reference indicates that the legislature did not intend shareholders' equity and capital notes to be interpreted as synonymous.

The Court finds that even though the Financial Code distinguishes between shareholders' equity and capital notes, the State Banking Department's letter and the capital note's mandatory convertibility into common stock combine to support the conclusion that the capital note should be included in the computation of contributed capital.[5]

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[5] Counsel for defendants appeared to contend at the hearing that viewing the capital notes as part of contributed capital would somehow violate Financial Code §670. However, that section only serves to place restrictions on the payment of sums on account of the principal of such notes. No principal payments are at issue in the instant circumstances.

Similarly, counsel for defendants made an argument against inclusion of the capital notes on the ground that FDIC approval was required and had not been granted. The Administrative Record at P.586 does reflect that by the terms of the State Banking Department's approval of the issuance of the capital notes, FDIC approval is required for sale or conversion of the notes.

However, even when the capital notes are added to contributed capital, the bank's deficit retained earnings still exceed 40 percent of contributed capital.[6] In other words, even with the capital notes included, contributed capital was impaired at the time of the superintendent's actions. Therefore, unless the Court also finds that the allowance for loan losses should be included in contributed capital or that certain adjustments to the computation of deficit retained earnings should be considered, the Court must grant summary judgment in favor of defendants.

2. Allowance for Loan Losses

Plaintiffs' chief argument for including the allowance for loan losses in the computation of contributed capital

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However, the Court is of the view that neither a sale nor conversion of the capital notes is necessary for purposes of the computation of contributed capital under §134. This position is supported by the implications apparent in the State Banking Department's letter of October, 1988, which grants sweeping rights to the bank to include the capital notes in capital computations without sale or conversion of the notes.

[6] The revised computation, based on the bank's internal consolidated balance sheet as of July 31, 1990, would be as follows:

common stock	$1,922,865
additional paid-in capital	3,023,015
subordinated capital note	844,000
contributed capital	$5,789,880
	x 40%
	$2,315,952
deficit retained earnings	$2,531,073

Here, deficit retained earnings exceed forty percent of contributed capital.

is that state and federal regulations controlling capital requirements for lending limit purposes include allowances for loan losses in their computations of lending maximums. *See* Financial Code §§1221(a), 1221(b), 1224(a), 1225, and 1231(d); and FDIC examination guidelines cited in Decl. of Miron, para. 18.

In response, defendants argue that the capital definitions cited by plaintiffs – which all relate to lending limits – have nothing to do with the determination of impairment of capital for purposes of regulatory action under California law. Defendants also argue that the one federal regulation that is analogous to the instant inquiry – that which controls the determination of insolvency and eligibility for receivership – excludes allowance for loan losses from its definition of common shareholders' equity. 12 CFR §5.49(c)(1)(i)(A). Further, defendants argue that the loan loss allowance is not an unencumbered fund which may be freely transferred to shareholders' equity. Instead, defendants explain that, in accordance with Generally Accepted Accounting Principles, loans must be stated at net realizable value. A loan loss allowance is merely a part of a two-part entry necessary to reduce the statement of loan values to their net realizable value.

The Court is inclined to adopt the position urged by defendants. Nothing presented by plaintiffs supports use of loan loss allowance in the computation of contributed capital in a capital impairment analysis. All of plaintiffs support comes from the context of lending limits based on capital. At most, the Financial Code sections cited by plaintiff allow summation of shareholders' equity, capital notes, and allowance for loan losses in computation of the bases for various lending limits. In no instance do these

sections indicate that allowance for loan losses is somehow part of contributed capital or shareholders' equity. Further, the Court views the defendants' explanation of net realizable value of loan balances as additional persuasive authority for excluding the Bank's loan loss allowance from the definition of contributed capital.

Hence, the Court must conclude that allowance for loan losses is not an item appropriately included in the computation of contributed capital.

3. Deficit Retained Earnings

It is undisputed that in concluding that the bank's contributed capital was impaired, the superintendent relied upon the bank's own internal financial statements. Plaintiffs contend that these informal internal financial statements do not reflect certain adjustments that become necessary when the statements are to be used for external purposes such as capital impairment analysis.

The declaration of Jose M. Anotado, controller of First Pacific Bank, states that certain adjustments necessary for an accurate presentation of the bank's financial condition are only made on a quarterly basis and are not reflected in the July 31, 1990 statements used by the superintendent. Most notably, Mr. Anotado declares that an adjustment for $148,500 is necessary to reverse out over-accrued reserves for expenses. This adjustment would increase current period income, hence increasing deficit retained earnings as of July 31, 1990. *See* Anotado Decl. at para. 26 and Ex. C attached thereto. His presentation also includes a sizable adjustment for unaccrued income. Importantly, if the Court adopts the adjustments

outlined by Mr. Anotado, in addition to finding that capital notes should be part of contributed capital, the bank would narrowly avoid a conclusion of statutory contributed capital impairment (by less than $3,300).[7]

In response, the defendants argue that the adjustments cited by plaintiffs are only those which would tend to increase deficit retained earnings.[8] At the hearing, defendants also raised some question about the amount of certain accruals outlined by Mr. Anotado because the adjustments reflect full month accruals for August, 1990, while the Bank was seized as of August 10, 1990.

The Court finds that formal accounting adjustments to the Bank's internal trial balances should have been considered by the defendants in their computation of impairment of contributed capital. Fundamental fairness

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[7] Adopting the adjustments from Ex. C to the Anotado declaration, the impairment analysis is as follows:

common stock	$1,922,865
additional paid-in capital	3,023,015
subordinated capital note	844,000
contributed capital	$5,789,880
	X 40%
40% of contributed capital	$2,315,952
deficit retained earnings per unadjusted statements	$2,531,073
over-accrued expenses	(148,500)
income items not accrued	(69,844)
adjusted deficit R/E	$2,312,729

[8] Unfortunately, defendants do not specify adjustments that would worsen deficit retained earnings, and correspondingly, move the bank back into technical impairment of contributed capital.

requires that an act as serious as seizure of a bank's assets and business must not be done on the basis of inaccurate or incomplete information. However, the Court finds that a genuine issue of material fact exists as to nature and amount of the adjustments to retained earnings proposed by plaintiffs. While the defendants' critique of the adjustments proposed by plaintiffs is too incomplete to be conclusive, it does raise questions about exact amounts of the adjustments. Moreover, the Court must insist on precision in this computation in view of the extremely small margin of error pointed up by Mr. Anotado's proposed computation.

Accordingly, in view of the Court's determinations that the capital notes may be included in the computation of contributed capital of the bank and that a genuine issue of fact exists as to the amount of the required adjustments to the bank's retained earnings, the Court finds that a genuine issue of material fact exists as to whether contributed capital was impaired on the date of the superintendent's action. Therefore, defendants motion for summary judgment must be denied.

Conclusion

The Court's denial of defendants' summary judgment motion is made without prejudice. In accordance with the analysis outlined above, a fairly narrow supplementation to the material previously presented to the Court may well settle the impairment issue rather readily, one way or the other. Further, because summary judgment in favor of defendants would have ended the case and make consideration of the other motions unnecessary, the Court

limited argument at the May 6, 1991 hearing to the summary judgment issue.

For these reasons, the Court HEREBY ORDERS that further hearing in this matter be held on June 10, 1991, at 2:30 p.m. in courtroom 15. At that time the Court will hear argument regarding the other motions originally scheduled for argument on May 6, 1991. Further, such hearing could be used to entertain renewal of defendant's summary judgment motion, should defendants wish to do so, consistent with the findings of this Order.

IT IS SO ORDERED.

Dated: MAY 15 1991

/s/ John G. Davies
JOHN G. DAVIES
United States District Judge

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

FIRST PACIFIC BANK, and FIRST PACIFIC BANCORP, INC., Plaintiffs, v. JAMES E. GILLERAN, SUPERINTENDENT OF BANKS, et al., Defendants.	CASE NO. CV 90-6563 JGD ORDER GRANTING DEFENDANTS' RENEWED MOTION FOR SUMMARY JUDGMENT (Filed Jul. 8, 1991)

On June 17, 1991, the Court heard argument of defendants' renewed motion for summary judgment. After consideration of the arguments offered at that hearing, as well as those in the written briefing, the Court HEREBY GRANTS defendants' motion for summary judgment.

This case is essentially an administrative challenge to the actions of the California State Banking Department. On August 10, 1990, the defendant regulators seized the plaintiffs' property and business pursuant to Financial Code §3100, based, *inter alia*, on an alleged impairment of contributed capital.

On May 15, 1991, the Court issued an Order denying defendants' initial motion for summary judgment. In that motion, the central issue was whether the bank's contributed capital was statutorily impaired on August 10, 1990, the date of the Superintendent of Banks' seizure of its

business and property.[1] After determining which balance sheet items should, and should not, be included in the computation of contributed capital[2], the Court found that the outcome of the impairment analysis boiled down to whether the regulators should have made certain income and expense adjustments to the bank's internal financial statements, hence altering the bank's deficit retained earnings.

In the May 15, 1991 Order, the Court found that because defendants had not addressed the adjustments issue adequately, genuine issues of material fact existed which precluded a finding that the adjustments were not necessary. In turn, the Court could not conclude that the bank's capital was impaired on the date of takeover, and summary judgment could not be granted. But the May 15, 1991 Order invited the defendants to renew their summary judgment motion, focusing specifically on the adjustments issue.

Standard

The moving party bears the initial responsibility of informing the district court of the basis for its motion, and identifying those portions of the record which it believes demonstrate the absence of a genuine issue of

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[1] Financial Code §134 provides that contributed capital is impaired when deficit retained earnings exceeds 40% of contributed capital.

[2] The Court found that the bank's capital note should be included in contributed capital, but that allowance for loan losses should not be so included. *See* May 15, 1991 Order at p.6-10.

material fact. *U.S. v. Wilson*, 881 F.2d 596, 601 (9th Cir. 1989) *citing Celotex Corp. v. Catrett*, 477 U.S. 317, 323, 106 S.Ct. 2548, 2553, 91 L.Ed.2d 265 (1986). The non-moving party must then offer evidence of such a caliber that a fair minded jury could return a verdict for the non-moving party on the evidence presented. The mere existence of a scintilla of evidence in support of the non-moving party's position will be insufficient. *Id. citing Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 252, 106 S.Ct. 2505, 2512 (1986). However, in assessing the non-moving parties' presentation, a court must consider the evidence in the light most favorable to the non-moving party. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. at 255, 106 S.Ct. at 2513 (1986).

Discussion

Defendants' position in the renewed motion is that the bank's contributed capital was impaired, even using the figures from its own books and giving recognition to the adjustments it proposes, if one over-accrual (for RIWN interest) is restated to reflect amounts attributable to only the first ten days of August. Their argument relies upon the declaration of Masanori P. Yamaguchi, a Certified Public Accountant employed by the California State Banking Department. His declaration analyzes the proposed adjustments offered by plaintiffs in the first declaration of Jose Anotado, filed in support of plaintiffs' opposition to the original summary judgment motion.

Yamaguchi appears correct in his contention that footnote 3b.of Exhibit D. of Anotado's original declaration suggests that amounts for both July and August were included in the proposed RIWN interest adjustments.

Footnote 3b. is, in fact, entitled "Income accrual of various RIWN's for July & August which were not taken up." The amount is $139,688. Supporting his conclusion that the $139,688 figure includes a full monthly accrual for August, Yamaguchi points out that Ex. C to the original Anotado declaration reflects a RIWN accrual of $69,844 for July, 1990. Yamaguchi notes that $139,688 is exactly twice as much as $69,844, leading him to conclude that $69,844 is a full monthly accrual for the RIWN's, and that Ex. D, footnote 3b. included full accrual for both months.

From his conclusion that plaintiffs have included a full month's RIWN accrual for August in their proposed adjustments, Yamaguchi goes on to compute the corrected accrual as $69,844 multiplied by ten (the number of days in August prior to the seizure) divided by thirty one (the total number of days in August), or $22,530. At Ex. A of his declaration, he inserts this corrected accrual into the impairment analysis, and concludes that the bank's capital was impaired as of August 10, 1990.

However, in response to Yamaguchi's computations, plaintiffs offer a second declaration of the bank's controller, Jose Anotado. At para. 1 of that declaration, Anotado states:

> "The RIWN accrual amount shown on Exhibit 'D', at footnote (3)b., did not include any accrual for the month of August 1990. Rather, the amount of $139,688 represented thereon, was an amount that had not yet been taken up previously, for June 1990 and July 1990, only, but was *taken up* in the month of August 1990 for the

> purpose of preparing a statement of condition as of August 10, 1990" (emphasis original).

At para. 3 of that declaration Anotado adds:

> "I declare that there was no provision whatsoever for accrual of income on the RIWN's for the month of August 1990, and that any reference thereto in Exhibits 'C' and 'D' to my prior declaration was inadvertent error. The aggregate sum of $139,688 on Exhibit 'D' is comprised solely from accruals of income for the RIWN's for June 1990 and July 1990, only."

Attached as Ex. C to Anotado's second declaration is a revised impairment computation, reflecting RIWN accruals for June and July, instead of July and August. Under this analysis, the bank's contributed capital was not statutorily impaired at the relevant date.

To rebut the second Anotado declaration, the defendants filed a supplemental declaration of Masanori Yamaguchi, the C.P.A. at State Banking Department. The thrust of that supplemental declaration is that a double-counting of the RIWN accrual for June, 1990 would result were the Court to adopt the RIWN adjustment described by Anotado in his second declaration.

Yamaguchi supports his supplemental assertion by reference to Adm. Rec. p. 03920-03934, attached as Ex. A to his supplemental declaration. His argument is that the bank's July 31, 1990 general ledger[3] already includes six

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[3] Yamaguchi contends that the impairment analysis included in Ex. C of Anotado's first declaration begins with the figures on the bank's July 31, 1990 general ledger.

months accrual for RIWN income.[4] Hence, to bring the RIWN accrual current through August 10, 1990 (the date of the regulators' action), no June accrual is necessary. Only an accrual for one whole month (July), plus ten days (August 1-10) is required. Therefore, he argues, the Court should reject the explanation of RIWN accruals provided in Anotado's second declaration and should, instead, adopt the reasoning of the renewed motion. I.e. using the bank's own books, and the bank's proposed adjustments, capital was impaired on August 10, 1990 if the bank's RIWN adjustment is restated. *See* Ex. A to the original Yamaguchi Declaration.

The Court finds the Yamaguchi evidence to be conclusive. Anotado's second declaration was immediately somewhat suspicious in its mysterious reference to the necessity for a RIWN accrual for June (to replace the express reference to an August accrual in Ex. D to his original declaration). But the analysis provided in the supplemental Yamaguchi declaration firmly refutes the need for a June accrual. Hence, the Court finds that no genuine issue of material fact remains as to the proper adjustment for the accrual of income from the bank's RIWN's. The appropriate computation is found in the Yamaguchi declaration, para. 7.[5]

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[4] The July 31, 1990 general ledger figure for RIWN income (a.k.a. HUD Notes Purchased) is $419,623. Adm. Rec. at p.03920. Yamaguchi contends that the monthly accrual is $69,844, per Ex. C to the first Anotado Declaration. Six months times $69,844 equals $419,623.

[5] The Court also received and considered a declaration filed on June 14, 1991, by plaintiffs' counsel William A. Klapperman. This declaration was filed in response to the supplemental

While it may seem inequitable to grant summary judgment on the basis of a seemingly technical accounting issue, Financial Code §134's test for statutory impairment of contributory capital is very straightforward. Applying that test, and based on the rulings made both in the previous motion for summary judgment and in this renewed motion, the Court finds that no genuine issue of fact remains as to whether the bank's capital was impaired on August 10, 1990. *See* Yamaguchi Declaration, Ex. A. Accordingly, the Court must grant the renewed motion for summary judgment.[6],[7]

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declaration of Masanori Yamaguchi. The analysis offered by Mr. Klapperman does not refute the conclusions reached by Mr. Yamaguchi or the Court.

In analyzing the RIWN accrual issue, Yamaguchi's computations make direct use of the bank's general ledger. On the other hand, the Klapperman declaration points to certain supplemental work papers in the administrative record in an effort to raise questions about Yamaguchi's conclusions. The Klapperman declaration does not explain how the supplemental calculations to which it refers are reflected on the books of the bank or the purpose for which those schedules where prepared. Accordingly, the Court finds that Klapperman's reference to the supplemental HUD Notes schedules does not raise a genuine issue about the appropriate RIWN adjustment.

[6] Based on the Court's ruling on this motion, it need not reach plaintiffs' motion for stay, plaintiffs' motion to compel discovery, or defendants' motion for sanctions.

[7] Plaintiffs also argue that a grant of summary judgment at this stage of the proceeding is inconsistent with their statutory right to judicial review pursuant to Financial Code §3101. However, §3101 only calls upon the Court to hold a hearing and determine the facts, and then conclude whether the superintendent should be enjoined or ordered to surrender the property seized. The Court has held such hearings and made a

IT IS SO ORDERED.

Dated: JUL 03 1991

/s/ John G. Davies
JOHN G. DAVIES
United States District Judge

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determination of the facts sufficient to dispose of plaintiffs' application for relief. Hence, plaintiffs have been denied no rights afforded them by §3101.

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

FIRST PACIFIC BANK; FIRST PACIFIC BANCORP, INC., Plaintiffs-Appellants, -vs- JAMES E. GILLERAN; CALIFORNIA STATE BANKING DEPARTMENT; FEDERAL DEPOSIT INSURANCE CORPORATION, as Receiver for First Pacific Bank, Defendants-Appellees.	No. 91-55890 D.C. No. CV-90-6563-JGD (Filed Jan. 12, 1995)
FIRST PACIFIC BANK; FIRST PACIFIC BANCORP, INC., Plaintiffs-Appellees, -vs- JAMES E. GILLERAN; CALIFORNIA STATE BANKING DEPARTMENT, Defendants-Appellants.	No. 91-56081 ORDER DENYING REHEARING

Before: WALLACE, Chief Judge, REINHARDT, Circuit Judge, and TANNER,* District Judge.

*Honorable Jack E. Tanner, United States District Judge, Western District of Washington, sitting by designation.

The panel as constituted above has voted to deny the petition for rehearing and to reject the suggestion for rehearing en banc.

The full court has been advised of the suggestion for rehearing en banc, and no judge of the court has requested a vote on the suggestion for rehearing en banc. Fed. R. App. P. 35(b).

The petition for rehearing is denied, and the suggestion for rehearing en banc is rejected.